

**FAIR POLITICAL PRACTICES COMMISSION**  
**Memorandum**

**To:** Chairman Randolph, Commissioners Blair, Downey, Karlan and Knox

**From:** John W. Wallace, Assistant General Counsel  
Luisa Menchaca, General Counsel

**Subject:** Adoption Discussion of “Has Reason to Know/Reasonable Diligence”  
Regulation

**Date:** July 15, 2004

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**I. Executive Summary**

This project is in response to the Commission’s request to examine whether a regulation clarifying section 87100’s “has reason to know” language would provide public officials with greater certainty as to the application of the conflict-of-interest provisions of the Political Reform Act (“Act”).<sup>1</sup> This regulation only applies to situations in which a public official has *no actual knowledge* as to whether a governmental decision of his or her agency’s will have a reasonably foreseeable material financial effect on the official’s economic interests. We do not describe what constitutes actual knowledge in this memorandum.

The approach under the proposed regulation establishes that a public official has a duty of “reasonable” diligence in determining whether he or she “has reason to know” of a potential conflict of interest. In addition, the regulation provides that a public official’s duty to comply with sections 87100 and 87103 is non-delegable. Finally, an alternate version has been prepared at the Commission’s direction that also provides illustrative examples of steps, which, when taken by an official, could demonstrate his or her exercise of the required diligence.

**II. Background**

Prior to this adoption hearing, the following activity has occurred regarding this regulation:

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<sup>1</sup> All references are to the Government Code sections 81000 – 91014 unless otherwise noted. All regulatory citations are to Commission regulations at Title 2, sections 18109 – 18997, of the California Code of Regulations.

- *Interested Persons' Meeting:* The staff held an "Interested Persons'" meeting on March 24, 2004, which was attended in person or by telephone by a total of 15 individuals, in addition to Commission staff.<sup>2</sup>
- *Pre-notice Discussion:* The Commission considered this item at a pre-notice hearing in May 2004. The Commission made multiple preliminary decisions, including directing staff to return with two versions of the regulation, one that encompassed only proposed subdivisions (a) and (d) (setting forth the official's non-delegable duty of "reasonable" diligence), and a second version that also contained examples.

### III. Discussion

#### A. *"Has Reason to Know" as an Element of a Conflict of Interest*

Section 87100 provides:

"No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he *knows or has reason to know* he has a financial interest."  
[Emphasis added.]

Section 87103 defines a "financial interest" as a reasonably foreseeable material financial effect on one or more of the official's economic interests, which is distinguishable from the effect upon the public generally. A conflict of interest is identified from responses to the following questions:

- Is the individual a "public official"?
- Will the public official be making, participating in making, or influencing a governmental decision?
- What are the public official's economic interests?
- Will one or more of those economic interests be directly or indirectly involved in the governmental decision?
- Based on the applicable materiality standard, is the financial effect of the governmental decision on those economic interests "material"?

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<sup>2</sup> This included representatives from the California State Treasurer's Office, California State Food and Drug Administration, California Association of Realtors, San Diego City Ethics Commission, Los Angeles County Board of Supervisors, Los Angeles Transit Authority, several local law firms, and three law students from the University of California's Hastings College of the Law.

- Is the material financial effect of the governmental decision on the public official's economic interests reasonably foreseeable?

The Act also provides two exceptions that may allow an otherwise disqualified official to participate in a governmental decision. They are:

- The "public generally" exception.
- The "legally required participation" exception.

The Commission's standard eight-step analytical process does not incorporate a separate step at which an official is to consider whether he or she "has reason to know" that he or she has a financial interest in a decision. Yet this statutory requirement has been the subject of several advice letters in the past, and has been considered in the context of enforcement actions.

Generally, the requests for written advice questioned whether, or under what circumstances, a public official has a duty, under the "has reason to know" language, to conduct an inquiry to determine the existence of a financial interest. To a lesser extent, these officials have sought advice as to whether that duty may be delegated to third parties. For example, in the *Price* Advice Letter, No. A-85-165, we advised:

"As a general rule, an official 'has reason to know' that a decision will affect a source of income whenever a reasonable person, under the same circumstances, would be likely to know the identity of the source of income and would be aware of the decision's probable impact on that source. An official engaged in a business which has numerous customers or clients is not ordinarily required to take affirmative steps to familiarize himself or herself with the identities of all sources of income to the business, nor to consult his or her sources of income to determine whether a decision will affect them."

In the *Christiansen* Advice Letter, No. I-87-019, the public official's spouse was a 50% partner in an accounting partnership. The official's spouse was unwilling to disclose the identity of her clients to the official, citing professional confidentiality concerns. Thus, the official questioned whether the "knows or has reason to know" requirement would be met if the following steps were taken:

- The city staff would prepare in advance a list of applicants expected to appear on the next city council agenda, together with the subject matter of the items;
- This list would be reviewed with due diligence by staff of the spouse's partnership to identify any sources of income of \$1,000 or more which were

applicants on the supplied list. If so, the official would be advised of that fact; and

- The official would disqualify herself with respect to any agenda item in which the applicant was a client providing the partnership with income of \$1,000 or more.

The advice letter concluded that this was a “good approach” and would be evidence of the official’s good faith effort to comply with the disqualification requirements of the Act.

In *In re Smoley* (1989) FPPC No. SI-86/370 (“*Smoley*”), an enforcement stipulation,<sup>3</sup> the Commission found that the respondent knew that a person involved in that particular governmental decision was either directly or indirectly a source of income to her at the time she made a governmental decision despite incorrect advice to the contrary. The Commission found:

“Mrs. Smoley should not have relied on Mr. Bell’s advice and should have questioned that advice. The written advice of her attorney was based on certain assumptions, which were stated in his letter to her. These assumptions were contrary to the terms of the pre-nuptial agreement. Mrs. Smoley was aware of the terms of the agreement and *knew, or should have known*, that the advice of her attorney failed to consider essential elements of her pre-nuptial agreement.” [Emphasis added.]

Thus, the “has reason to know” element of section 87100 was applied in *Smoley* both to establish a violation of the Act in the first instance, and also to impose a duty on the official for which the failure to perform constituted an aggravating factor when determining the appropriate penalty.

#### *B. Specific Decision Points*

*Version 1:* The first question to consider is whether any new regulatory language is needed, or will make it easier for a public official to comply with the law. During Phase 2 of the Conflicts of Interest Regulations Improvement Project a similar request for regulatory action was considered by the Commission and Commission staff (Project C). Commission staff concluded, and the Commission agreed at that time, that the proposed “has reason to know” was difficult to define.

Despite these concerns, staff recommends codification of a general “reasonable diligence” standard as proposed in version 1. Under the proposal, the public official

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<sup>3</sup> Neither the Act nor Commission regulations explicitly require that a Commission enforcement decision be given precedential value. This means the Commission is not obligated to follow the interpretations or rulings of an enforcement decision (including *Smoley*) in subsequent proceedings involving other parties.

would be required to exercise reasonable diligence in determining whether a governmental decision would have a reasonably foreseeable material financial effect on one or more of the official's economic interests. If a public official lacks information, then he or she must undertake a factual inquiry of such scope and effort as a reasonably prudent public official would undertake in similar circumstances when facing the same or a similar decision, in order to acquire the necessary information. Staff believes this is a helpful common-sense general rule and consistent with prior construction of the phrase "has reason to know" by the Commission.

The staff proposal also contains a provision that describes one attribute common to any methodology by which a public official could involve third-party assistance; that is, no matter what methodology is employed, *the public official is unable to delegate his or her duty to comply with the conflict-of-interest provisions of sections 87100 and 87103*. In other words, the official must use reasonable diligence in selecting the agent and methodology, and ultimately is responsible for the sufficiency or reasonableness of its operation.

*Version 2:* Version 2 contains the same language as version 1. However, in addition, version 2 includes a subdivision that sets out examples of reasonable diligence. For example, all of the following would be considered evidence of reasonable diligence:

“(1) Reviewing relevant publicly available material prepared by the public official's agency in connection with the governmental decision at issue, together with any other information provided to the public official by his or her agency;

“(2) Undertaking the standard conflict-of-interest analysis described in 2 Cal. Code Regs. Division 6, chapter 7, article 1, sections 18700 – 18709);

“(3) Reviewing any relevant publicly available materials prepared by the Fair Political Practices Commission; examples of such potentially relevant material include fact sheets, advice summaries, opinions and other library materials of the Fair Political Practices Commission, as well as its past written advice rendered under Government Code section 83114 and 2 Cal. Code Regs. Division 6, chapter 3, article 1, sections 18329 and 18329.5;

“(4) Obtaining from the Fair Political Practices Commission an opinion or written advice under Government Code section 83114 and 2 Cal. Code Regs. Division 6, chapter 3, article 1, sections 18329 and 18329.5; and

“(5) Reviewing any other relevant information in the possession of, or under the control of, the public official or members of the official’s immediate family, or any representative or agent of the foregoing.”

The downside of providing these examples is that it is difficult to accurately state a “one size fits all” approach to defining what is inherently a “common sense” standard (i.e., “reasonable”), particularly given the variety and number of potential decisions for which the standard will be applied. On the other hand, without some factual examples, the general rule may be too subjective to be helpful.

**Staff recommendation.** Staff recommends adoption of version one which contains the general rule and the rule against delegating an official’s duties under the Act. Staff believes that the provisions are helpful in codifying the approach set out in multiple Commission letters and stipulations. Staff recommends rejection of version 2 which contains examples of what factual scenarios qualify as due diligence. These factual scenarios run the danger of becoming a perceived exclusive list despite language in the regulation to the contrary.